# Will Governments Lose Monetary Control to Facebook's Libra Cryptocurrency?

https://www.e-ir.info/2019/09/04/will-governments-lose-monetary-control-to-facebooks-libra-cryptocurrency/

JOHN HAWKINS, SEP 4 2019

Facebook has announced it will launch a new digital currency called Libra in 2020. What implications might this have for the ability of national governments to control the monetary system? Possibly none. As discussed below, Libra faces considerable regulatory and political headwinds. There may also be consumer resistance given Facebook's patchy record with the privacy of customer data. There is, furthermore, a history of attempts to launch alternative currencies and payments systems that have failed, from Mondex and Digicash in the 1990s to Bitcoin and other cryptocurrencies more recently. Even Facebook itself had launched Facebook Credits in 2009 before abandoning it in 2013.

But this time it *could* be different. Facebook has very deep pockets and claims to have over 2 billion monthly users. Furthermore, it is not only Facebook backing Libra. A consortium of companies including Mastercard, Visa, Paypal, eBay, Uber, Spotify and Vodafone (although notably no banks) have contributed at least $10 million each to become founder members of the Swiss-based Libra Association. According to the white paper released by the Association, it is planned to have around a hundred members by the time Libra becomes operational.

Libra will employ some form of the blockchain technology used by cryptocurrencies such as Bitcoin, Ethereum, Litecoin, Tether and Dogecoin. Libra payments will be able to be made using a digital wallet, named Calibra, integrated into Facebook's Messenger and WhatsApp applications. A challenge for Libra will be balancing concerns about privacy and concerns about libras becoming the currency of choice for money laundering or illegal activities. The Association has promised that Facebook itself will not have access to financial data on Calibra. The white paper refers to the Libra blockchain as 'pseudonymous and allow[ing] users to hold one or more addresses that are not linked to their real-world identity'.

**The Attraction of Libra**

How attractive will this product be? Domestic payments systems in many advanced economies are now relatively quick, cheap and efficient and many will soon be even better. In Sweden and the Netherlands, for example, consumers can already instantaneously transfer funds for free using a text message. Libra may struggle to make much impact in such markets unless they adopt a very aggressive strategy of below-cost pricing.

If Libra payments are more efficient and much less costly than existing systems, then there may be scope for them to be used for a wider range of transactions than existing payments systems. For example, many internet content providers expected to fund themselves by selling advertising space on their sites. This has proved much harder to do than expected, as the market becomes saturated and consumers increasingly ignore such advertisements. Some content providers would like to switch to charging users a small amount to access some information, read an article or listen to a song. These micropayments are uneconomic if the existing credit card network has to be used but could be well-suited to payments using libras.

Libra is most likely to be an attractive alternative in developing countries. It could be particularly useful for making cross-border payments such as remittances which, as the Bank of England governor has pointed out, can take up to a week and cost up to ten times as much as domestic payments. For example, 'a Pacific islander picking fruit in Australia today may have to spend between $25 and $50 to send home $500.' According to the Libra members' white paper, a focus will be on empowering the billion adults with a mobile phone but no access to a traditional bank, who predominantly live in developing economies.

An important distinction between Libra and Bitcoin, which could potentially allow it to gain wider acceptance, is that while Bitcoin's value fluctuates wildly against national currencies such as the dollar, euro and renminbi, the libra's will be tied to the value of major currencies. The white paper describes how Libra will be fully backed by a reserve of bank deposits and short-term government securities held by a geographically distributed network of custodians. This sounds something like the currency boards dating back to the nineteenth century in some British colonies and most prominent in their modern day forms in Hong Kong, Bulgaria and the Eastern Caribbean, and used as transitional currencies in Estonia and Lithuania.

**The Libra Reserves**

It is not clear whether the basket of international currencies will be an existing one such as the IMF's Special Drawing Right (a basket of the US dollar, euro, renminbi, yen and pound sterling) or a new one. Being tied to any basket, however, means that holders of libras will face some currency risk in terms of their own national currency. It also means that the impact of Libra will differ between those, presumably large and rich, economies whose currencies will be part of the Libra basket and those not included. If Libra becomes very large then it will skew demand for government securities and bank deposits towards those denominated in currencies of the former.

The interest earned on the reserve assets will not be passed on to Libra users. It will be, along with fees, a source of revenue to the Libra operators. (It is therefore a little odd that the Libra Association describes itself as 'not for profit'.) In normal times this revenue, termed 'seigniorage' when earned by central banks, could be substantial. But currently bonds in Japan and a number of European economies have a negative yield. These 'bizarro bonds' would actually detract from revenue. This could push the Libra syndicate to move towards bonds which still offer a positive return, such as those of China, India and Brazil. If this shift is large it could shift down yields and push up exchange rates in these countries.

**Monetary Policy**

What then would be the implications for policymakers if a significant proportion of the population transacts using libras rather than dollars or euros?

Central banks would lose some of their 'seigniorage' revenue discussed above. It seems likely, however, that legitimate libra transactions would mainly replace those already made electronically rather than replacing those made using notes and coin. So, this effect may only be significant if criminals switch from using large denomination banknotes to using libras.

Monetary policy in most countries today is implemented through the central bank's role as the operator of the inter-bank settlement market and the monopoly supplier of liquidity to it. This allows them to control closely the inter-bank interest rate. When central banks announce changes in their target for the inter-bank interest rate, this will generally be quickly passed through into bank deposit and lending rates, thereby affecting economic activity. If payments move to libras from national currencies the size of these interbank markets will shrink. At an extreme, the central bank might become, in Benjamin Friedman's analogy, 'an army with only a signal corps'. But so long as governments require taxes to be paid in their national currency the demand for these national currencies will not totally dry up and so the inter-bank market for it will continue to exist, even if on a smaller scale. The central bank will still influence the interest rate on loans and deposits denominated in their national currency.

There is a risk though that while the central bank controls the interest rate on the national currency, this could become less relevant to economic activity as it is the interest rate on the global currency (libras) that becomes the more important influence. So, the question becomes what might cause banks to redenominate their loans from national currencies to libras. Most loans are taken out by consumers to buy homes, cars and large consumer durables, and by companies to buy capital equipment, and these do not seem the types of goods likely to be paid for in libras.

### Regulatory Issues

Beyond monetary policy, there are prudential concerns about the safety of holdings of libras and regulators are likely to seek assurance that the promised convertibility of libras back to national currencies can be truly guaranteed. There could also be concerns that the Libra system could become 'too big to fail' and thereby acquire an implicit and unpriced government guarantee.

Competition authorities may also be concerned about the number of large multinational corporations involved in the Libra project and its potential monopoly power. But it should increase competition in other markets by making it easier for consumers to compare prices and transact internationally.

In contrast to much of the techno-libertarian rhetoric surrounding cryptocurrencies, the white paper refers to collaborating with financial regulators. But gaining regulatory approval across a range of countries may be no simple matter, raising serious doubts about whether the first half of 2020 timetable can be met. The Bank of England has said it will approach Libra 'with an open mind but not an open door'. The Federal Reserve chair said it could not proceed until 'serious concerns' are resolved. At a political level, President Trump has tweeted that Libra will have 'little standing or dependability' and argued it would need to be regulated like a bank. China has a ban on cryptocurrencies. The French finance minister 'cannot accept private companies issuing their own currencies without democratic control'.

The Libra Association is based in Switzerland, outside the EU and US jurisdictions. So, it could ultimately decide to proceed without any imprimatur from the EU and the US. It does not need to establish physical offices to operate in a country. Without bank status it would not have access to reserve accounts with the European Central Bank or the Federal Reserve. It would not be covered by deposit insurance schemes. But it may not need these anyway. Even if some governments can somehow prevent Libra holding bonds and deposits in their currencies, Libra could just adjust the weights and back libras with other currencies. Ultimately governments in democracies may find it hard to shut down a service that is saving customers money. They may lose the argument if every customer of Facebook, Visa, Mastercard, eBay etc are being sent messages about the virtues of Libra.

### Future Challenges to Libra

Bitcoin fans may disapprove of Libra as it is not as decentralised. But this very lack of centralisation makes it hard for Bitcoin to respond to the challenge Libra poses to its position as the highest profile cryptocurrency. After a decade it is hard for Bitcoin to argue that the volatility of its price will reduce over time, whereas Libra is structured to ensure it is more stable. Bitcoin's acceptance for payments is miniscule. Even if only the members of the Libra Association itself accepted libras, this would still lead to vastly more places accepting libras for payments.

In the longer term the challenge to Libra (and other private cryptocurrencies) may come from a rival issued by an entity even more powerful. An electronic payment instrument backed by a large government and its central bank would be safer, have legal tender status and be guaranteed of wide acceptance. Already there are media reports that China will soon launch an official cryptocurrency and the Bank of England governor has speculated that what he terms a 'synthetic hegemonic currency' could be provided by a network of central banks. These could become truly global currencies.

### References

Carney, M (2019a) 'Enable, empower, ensure: a new finance for a new economy', speech by the Governor of the Bank of England, Mansion House, London, 20 June.

Carney, M (2019b) 'The growing challenges for monetary policy in the current monetary and financial system', speech by the Governor of the Bank of England, Jackson Hole Symposium, 23 August.

Del Castillo, M (2019) 'Alibaba, Tencent, five others to receive first Chinese cryptocurrency', *Forbes*, 27 August. (accessed 2 September 2019, https://www.forbes.com/sites/michaeldelcastillo/2019/08/27/alibaba-tencent-five-others-to-recieve-first-chinese-government-cryptocurrency/#36ed433d1a51)

Friedman, B (1999) 'The future of monetary policy: the central bank as an army with only a signal corps', *International Finance*, vol 2, no 3, pp 321-338.

Hawkins, J (2001) 'Electronic finance and monetary policy', *BIS Papers*, no 7, Bank for International Settlements, pp 98-105.

Hawkins, J (2004) 'A history of economic thought concerning currency boards', Paper presented to UK History of Economic Thought Conference, Leeds. (accessed 2 September 2019, https://www.researchgate.net/publication/282613501_History_of_Economic_Thought_Concerning_Currency_Boards)

Hawkins, J (2019a) 'Facebook's Libra plan: talk of the demise of central banks is greatly exaggerated', *The Conversation*, 25 June, (accessed 2 September 2019, https://theconversation.com/facebooks-libra-plan-talk-of-the-demise-of-central-banks-is-greatly-exaggerated-119165)

Hawkins, J (2019b) 'Guaranteed to lose money: welcome to the bizarro world of negative interest rates', *The Conversation*, 11 July, (accessed 2 September 2019, https://theconversation.com/guaranteed-to-lose-money-welcome-to-the-bizarro-world-of-negative-interest-rates-119994)

Kihara, L and Lawder, D (2019) 'G7 urges tough Libra regulation, agrees to tax digital giants', Reuters, (accessed 2 September 2019, https://www.reuters.com/article/us-g7-economy/g7-urges-tough-libra-regulation-agrees-to-tax-digital-giants-idUSKCN1UD0MS)

Libra Association (2019) *Libra White Paper* (accessed 2 September 2019; https://libra.org/en-US/white-paper/)

Rocco, M (2019) 'Jay Powell says Facebook's Libra raises serious concerns', *Financial Times*, 11 July.

Room, T and Paletta, D (2019) 'President Trump takes aim at Facebook's cryptocurrency, Libra, saying it should be regulated', *Washington Post*, 11 July.

Zetzsche, D, Buckley, R and Arner, D (2019) 'Regulating LIBRA: the transformative potential of Facebook's cryptocurrency and possible regulatory responses', *European Banking Institute Working Paper Series*, no 2019/44.

---

## About the author:

**Dr John Hawkins** is an assistant professor at the University of Canberra. He holds a PhD from the School of Politics and International Relations at the Australian National University. John currently mainly researches in Macroeconomics (especially central banking) and Australian political history and teaches in Economics, International Political Economy, Behavioral Economics and International Relations.